

A REPORT
TO THE
ARIZONA LEGISLATURE

Accounting Services Division

Status Review

Clifton Unified School District No. 3

As of February 15, 2008



STATE OF ARIZONA
OFFICE OF THE
**AUDITOR
GENERAL**

Debra K. Davenport
Auditor General

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STATE OF ARIZONA
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June 26, 2008

Governing Board
Clifton Unified School District No. 3
P.O. Box 1567
Clifton, AZ 85533-1567

Members of the Board:

In our July 2007 compliance review report, we notified you that the District had not complied with the *Uniform System of Financial Records* (USFR). The District was given 90 days to implement the recommendations in our report. We subsequently performed a status review of the District's internal controls as of February 15, 2008. The purpose of our status review was to determine whether the District was in substantial compliance with the USFR as of the date of our review. Our review consisted primarily of inquiries and selective testing of accounting records and control procedures. The review was more limited in scope than would be necessary to express an opinion on the District's internal controls. Accordingly, we do not express an opinion on its internal controls or ensure that all deficiencies were disclosed.

Based on the number and nature of the deficiencies noted in our status review and our review of the District's audit reports and USFR Compliance Questionnaire for the year ended June 30, 2007, which we received subsequent to the completion of our test work, the District still has not complied with the USFR. We also noted that the auditors qualified their opinion on the District's financial statements for the year ended June 30, 2007, because the District did not maintain adequate records of its capital assets.

Within a few days, we will issue a letter notifying the Arizona State Board of Education of the District's noncompliance and requesting that appropriate action be taken as prescribed by Arizona Revised Statutes §15-272. Recommendations to correct these deficiencies are described in this report. District management should implement these recommendations to ensure that the District fulfills its responsibility to establish and maintain internal controls that will adequately comply with the USFR. We have communicated specific details for all deficiencies to management for corrections.

Thank you for the assistance and cooperation that your administrators and staff provided during our status review. My staff and I will be pleased to discuss or clarify items in this report.

Sincerely,

Debra K. Davenport
Auditor General

TABLE OF CONTENTS



Introduction	1
Recommendation 1: The District must accurately record and report its student attendance	2
Recommendation 2: The District should maintain an accurate and complete capital assets list	3
Recommendation 3: The District's controls over cash should be improved	5
Recommendation 4: The District should improve controls over credit card purchases and other expenditures	7
Recommendation 5: The District should ensure the accuracy of its accounting records	8

INTRODUCTION

Clifton Unified School District No. 3 is accountable to its students, their parents, and the local community for the quality of education provided. The District is also financially accountable to taxpayers for over \$1.9 million it received in fiscal year 2007 to provide this education.

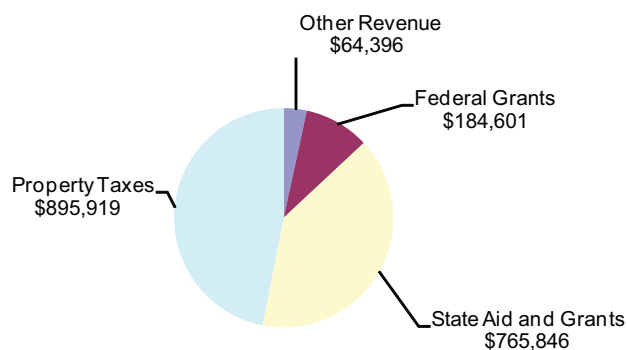
The District should use effective internal controls to demonstrate responsible stewardship for the tax dollars it receives. These controls are set forth in the *Uniform System of Financial Records* (USFR), a joint publication of the Office of the Auditor General and the Arizona Department of Education (ADE). The policies and procedures in the USFR incorporate finance-related state and federal laws and regulations and generally accepted accounting principles applicable to school districts. Districts are legally obligated to comply with USFR requirements, and doing so is good business practice.

As a result of our status review, we determined that the District had failed to comply with the USFR. In addition, because of inadequate capital asset records, the District's auditors qualified their opinion on the District's financial statements for the year ended June 30, 2007. We noted certain deficiencies in controls that the District's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship and continue to comply with the USFR. Our recommendations are described on the following pages.

District Facts Fiscal Year 2007

County: Greenlee
Number of Schools: 2

Number of Students: 128
Grade Levels: K-12



Source: *Annual Report of the Arizona Superintendent of Public Instruction for Fiscal Year 2006-2007 and Clifton Unified School District No. 3 Report on Audit of Financial Statements and Report on Internal Control and on Compliance for the Year Ended June 30, 2007.*

The District must accurately record and report its student attendance

The District may not have received the appropriate amount of funding because it did not report membership and absences correctly.

The State of Arizona provides funding to school districts based on student membership and attendance. In turn, the State requires school districts to maintain accurate attendance records to ensure the districts receive the appropriate amount of state aid and local property taxes. However, the District did not accomplish this objective. Specifically, the entry and withdrawal dates recorded in the District's computerized attendance system were not always accurate based on the students' actual attendance and did not agree with, or were not included on, the entry or withdrawal forms, as applicable. Also, the District did not maintain documentation to support that student entries and withdrawals were entered into the computerized attendance system in a timely manner.

In addition, attendance and absences reported in the District's computerized attendance system did not always agree to supporting documentation, absences were not always properly calculated for all grades, and teacher's attendance registers or other supporting documentation was not always retained. Finally, the membership and absences reported to ADE during the 40th-day reporting period did not agree to the District's attendance records.

Recommendations

To help ensure that the District receives the correct amount of state and local funding, the District should:

- Record and report membership and absences in accordance with ADE's *Instructions for Required Reports*.
- Indicate the student entry or withdrawal date and the date prepared on each entry or withdrawal form.
- Record entries or withdrawals in its computerized attendance system within 5 working days of the entry or withdrawal and document the date it was entered.
- Mark kindergarten students, with total instruction time between 346 and 692 hours per year, as absent if in attendance for less than 3/4 of the day. If instructional time for the year was 692 hours or more, students not in attendance at least 1/2 of the day should be counted as being absent.

ADE provides guidance for student attendance reporting requirements in its *Instructions for Required Reports*.

- Calculate attendance for students enrolled in first through eighth grades, if attendance is based on half-days, as follows:
 - Attendance of at least 3/4 of the instructional time scheduled for the day should be counted as a full day of attendance.
 - Attendance for at least 1/2, but less than 3/4, of the instructional time scheduled for the day should be counted as a half-day of attendance.
- Retain teacher's attendance registers or other supporting documentation and require a second employee to verify membership and absences reported to ADE to ensure they agree with the District's computerized attendance records.

The District should maintain an accurate and complete capital assets list

The District has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. Effective stewardship requires the District to maintain an accurate list of these assets. However, the District's capital assets list was not always accurate and complete. Specifically, numerous capital assets were not included on the capital assets list, some assets on the list could not be located on the District's premises, and several repair and maintenance items were inappropriately included on the list. The capital assets list also included inaccurate and incomplete information. In addition, the District did not always retain documentation to support the assets' costs recorded on the list or assign permanent tag numbers, and individual payments for several buildings or building improvements were improperly identified with separate identification numbers on the capital assets list.

Further, the District did not retain accurate depreciation records as the District did not include all applicable buildings, land and building improvements, equipment, and vehicles on the depreciation schedule, and did not always calculate depreciation correctly. Finally, the District did not update its capital assets list for differences noted in its most recent physical inventory, and did not reconcile the current year's capital assets list to the previous year's list.

The District's auditors qualified their opinion on the financial statements since the District did not maintain adequate capital asset records.

USFR pages VI-E-2 and 3 and USFR Memorandum No. 196 describe the information that should be recorded on the capital assets and stewardship lists.

Instructions for obtaining capital asset cost information are included on USFR pages VI-E-3 through 5.

Recommendations

The following procedures can help the District ensure that its assets are adequately accounted for and controlled:

- Maintain a current capital assets list that includes all equipment items costing \$5,000 or more and useful lives of 1 year or more and all land, buildings, and related improvements with costs of \$5,000 or more.
- Include multiple payments for the same asset as one item on the capital assets list.
- Maintain a stewardship list that includes all equipment items costing between \$1,000 and \$5,000, or the District's capitalization threshold as adopted by the Governing Board if less than \$5,000.
- Affix a permanent tag with an identifying number to each equipment item costing \$1,000 or more, or specifically identify the asset on the lists by some other means, such as a serial number.
- Record capital asset items at actual cost, including ancillary charges such as sales taxes; delivery charges; and installation, assembly, and other incidental charges.
- Retain documentation such as purchase orders, receiving reports, and vendor invoices to support the costs recorded.
- Remove repair and maintenance items from the capital assets list.
- Include all depreciable assets on the depreciation schedule and calculate depreciation accurately based on the District's useful life policy.
- Perform a physical inventory of capital assets at least every 3 years and reconcile the results of the inventory with the capital assets and stewardship lists, and add or remove items from the list as necessary.
- Reconcile items from the current year's capital assets list to the previous year's list and make all necessary corrections.

The District's controls over cash should be improved

The District receives cash from various sources and maintains several bank accounts. Because of the relatively high risk associated with cash transactions, the District should establish and maintain effective internal controls to safeguard cash. However, the District did not have adequate controls over its cash and bank accounts. Specifically, the District did not adequately separate cash-handling and recordkeeping responsibilities as one employee received, deposited, and recorded miscellaneous cash receipts. In addition, cash collection reports were not prepared for miscellaneous receipts, and documentation was not maintained to support that cash was deposited in a timely manner. Further, the District inappropriately deposited miscellaneous receipts into the Maintenance and Operation (M&O) Fund revolving bank account rather than with the County Treasurer. Specifically, the District deposited insurance proceeds, personal checks for employees' fingerprint fees, and monies to establish a memorial fund into the M&O Fund revolving bank account.

Poor cash controls left district and student monies susceptible to loss, theft, or misuse.

In addition, the District did not use the M&O Fund revolving bank account as prescribed by statute. For example, the District inappropriately wrote checks for retired employees' insurance premiums from the M&O Fund revolving bank account. Also, as a result of the inappropriate deposit of insurance proceeds into the account, the M&O revolving bank account exceeded its allowable imprest balance. In order to reestablish the correct imprest account balance, the District wrote a check to its Gifts and Donations Fund for the insurance proceeds amount. However, the monies should have been deposited into the District's Insurance Proceeds Fund.

Finally, the District holds student activities monies raised through students' efforts for safekeeping. Therefore, the District has a fiduciary responsibility to ensure that the monies are not misused, lost, or stolen. The Governing Board is responsible for establishing oversight of these monies to ensure that proper procedures are followed for collecting and spending them. However, proper oversight was not established. Specifically, the District did not always deposit student activities monies in a timely manner and did not maintain documentation to support that the disbursements were approved by the student clubs. The District also maintained several inactive student club accounts.

USFR §§VI-C and VI-F provide examples of appropriate separation of responsibilities.

USFR pages VI-C-3 and 4 describe M&O Fund revolving bank account procedures.

USFR pages X-H-9 through 11 describe disbursement processing procedures.

Recommendations

To strengthen controls over district and student monies, the District should:

Miscellaneous Cash Receipts

- Separate responsibilities adequately among employees so that one person does not have complete authority over a transaction cycle. If one employee must perform multiple functions, district management should require supervisory reviews at appropriate points in the process to help ensure that adequate internal controls are maintained.
- Prepare cash collection reports for miscellaneous receipts.
- Deposit miscellaneous cash receipts into a miscellaneous receipts clearing bank account or remit directly to the County Treasurer intact daily, when significant, or at least weekly and retain supporting documentation.

M&O Fund revolving bank account

- Operate the M & O Fund revolving bank account on an imprest basis so that the total of the unreimbursed payments from the account and the account balance is always equal to the authorized balance. As required by statute, the imprest amount of the account may not exceed \$10,000.
- Use the M&O Fund revolving bank account only for activities that require immediate cash outlay, such as postage, freight, travel, and other minor disbursements.

Student Activities

- Deposit cash receipts intact daily, if significant, or at least weekly.
- Retain documentation to support student activities disbursements, including club meeting minutes, requisitions, purchase orders, receiving reports, and vendor invoices.
- Close inactive student club accounts and transfer any remaining balances to the student council. The transfer should be authorized by both the student activities treasurer and the student council.

The District should improve controls over credit card purchases and other expenditures

The District spends public monies to purchase goods and services, so it is essential that the District follow USFR guidelines designed to help ensure that its expenditures are appropriate, approved, and adequately supported. However, the District did not always follow such procedures. Specifically, the District did not document that gas credit card purchases served a district purpose as it did not require receipts to include the vehicle license number or the authorized employee making the gas purchase. In addition, the District did not correctly account for credit balances on its credit card accounts that arose from merchant credits and duplicate payments. Also, the District failed to pay its credit cards bills on time and in full each month, and as a result, incurred late fees and finance charges.

The District did not always document that credit card purchases were for a district purpose and did not pay credit card balances in a timely manner, resulting in late fees and finance charges.

Further, the District paid an invoice in excess of the authorized purchase order amount, recorded expenditures in the incorrect fiscal year, and did not retain documentation indicating the Advice of Encumbrance was submitted to the County School Superintendent.

Finally, the District did not separate purchasing responsibilities and did not adequately control its supplies inventory. Specifically, the District did not separate responsibilities for ordering, approving, and receiving goods, and one employee performed the physical inventory of supplies and adjusted the supplies inventory list. Additionally, the District did not always include all supply items and purchase document numbers on the supplies inventory list, or retain documentation to support the actual cost of items recorded on the supplies inventory list.

Recommendations

To strengthen controls over credit card purchases and other expenditures and to comply with the USFR guidelines, the District should:

- Require employees using district credit cards to retain all supporting documentation for expenditures and promptly submit receipts to the business office. The receipts should clearly indicate on them the employee making the purchase and the specific district purpose for the expenditure. Receipts for fuel or vehicle repair should include the vehicle license number.
- Verify that credit card purchases represent valid district expenditures by comparing the billing statement to supporting documentation and pay the related charges in a timely manner to avoid late fees and finance charges. Adjust payments on credit card bills for any credit balances.

USFR pages VI-G-7 and 8 provide guidance on the proper use of district credit cards.

- Prepare purchase orders and have them approved by an authorized employee before goods or services are ordered. Purchase order amounts should not be exceeded without proper approval.
- Ensure that expenditures are recorded in the correct fiscal year by preparing an Advice of Encumbrance for liabilities payable as of June 30 for all levy funds and recording payments of those liabilities in the accounting records of the prior fiscal year during the 60-day encumbrance period following June 30. Goods and services received after June 30 should be recorded and paid in the next fiscal year.
- Retain documentation indicating the Advice of Encumbrance was submitted to the County School Superintendent.
- Separate purchasing and receiving responsibilities among employees so that one person is not responsible for both.
- Separate inventory responsibilities among employees so that one person is not responsible for recordkeeping and custodial functions. If one employee must be responsible for both functions, the District should implement additional supervisory review at appropriate points in the process to help ensure adequate internal control is maintained.
- Prepare a complete supplies inventory list that includes all required information and retain vendor invoices to support the costs of items recorded on the list.

The District should ensure the accuracy of its accounting records

The District's Governing Board depends on accurate information to fulfill its oversight responsibility and to report accurate information to the public and agencies from which it receives funding. To achieve this objective, management should ensure that its accounting records are accurate and complete. However, the District did not fully accomplish this objective. Specifically, the District did not always maintain its accounting records in accordance with the USFR Chart of Accounts, and journal entries were not always reviewed and approved by someone other than the preparer. In addition, the District did not ensure that all employees' time sheets were signed by the employee and a supervisor.

Further, the District incorrectly calculated its adopted expenditure budget, resulting in an adopted budget for the M&O Fund that exceeded applicable limits, and did not prepare a budget revision when notified of the error by ADE. Also, the District accumulated a fund balance of over \$40,000 in the Unemployment Insurance Fund that exceeded the District's insurance needs.

Recommendations

The following procedures can help the District record and report accurate financial information:

- Classify all financial transactions in accordance with the USFR Chart of Accounts.
- Require a supervisor to review and approve journal entries before they are posted to the accounting records. Retain documentation for all journal entries, including evidence of authorization.
- Ensure time sheets are signed by employees, and reviewed and signed by each employee's supervisor.
- Review the expenditure budget before adoption to ensure it is within statutory budget limits.
- Revise the adopted expenditure budget on or before December 15 when the District is notified by ADE that the adopted budget exceeded the General Budget Limit, Unrestricted Capital Budget Limit, or Soft Capital Allocation Limit by \$1,000 or more.
- Determine if monies accumulated for unemployment insurance at year-end exceeded insurance needs and use any excess to reduce the District's taxes in the following year by transferring the excess amount to the M&O Fund, Unrestricted Capital Outlay Fund, or Soft Capital Allocation Fund.